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Carl Icahn's 42.3 million shares of Texaco were grabbed up by investors.

Icahn sale a boon for investors

By Fred Williams

Sensing a bargain, institutional investors snapped up the 42.3 million shares of Texaco Inc. stock sold by financier Carl Icahn.

The investors — including pension funds, insurance companies and foreigners — bought the stock at between $49 and $49.63 per share, when it had sold the day before for $51.13 on the open market. Adding to its appeal is the prospect of an $8-per-share special dividend.

Among the buyers were the State of Wisconsin Investment Board, Madison; Bankers Trust Co. — Investment Management Group, New York; and Sun Bank Capital Management, Orlando, Fla.

Mr. Icahn sold his Texaco stock for $49 a share to three Wall Street brokerage firms — Goldman, Sachs & Co., Salomon Brothers Inc. and Shearson Lehman Hutton Inc. — for just more than $2 billion. The three, each of which bought one-third of the shares, quickly resold most of their shares a

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Hong Kong feels pinch

Pension funds cautious

By Curtis Vosti

U.S. pension investors in Hong Kong stocks are remaining calm during the upheaval in China, but some acted quickly at the first sign of trouble from the Beijing riots.

When martial law was declared in China May 20, the $1.1 billion pension fund of The LTV Corp., Dallas, immediately lowered its investments in the Hong Kong market to less than $1 million from $4.5 million.

"I learned a long time ago that when there's a problem in China, you're better off reducing your exposure dramatically," said Thomas Tull, director of employee benefit fund investments LTV. LTV's fund has been investing in Hong Kong for a decade.

But pension funds making their first moves overseas were shaken by the momentous events that sent the Hang Seng Index, the broad-based indicator of the Hong Kong market, reeling. The index posted a 22% loss — almost 600 points — the first trading day following the June 4 massacre in Beijing's Tiananmen Square, rising slightly during the next two days with 56- and 74-point gains.

For newer players, such as many public pension funds, "the events probably provide them with a good hook to hang on," said Toby Westbrook, vice president in charge of international consulting services for Callan Associates Inc., San Francisco. He said many trustees might be asking: "Do we really want to push into this?"

"They probably are going to stretch out their allocations a bit — especially with the dollar's recent strength."

Basil Schwan, assistant executive officer for the $46 billion California Public Employees' Retirement System, Sacramento, said the system has placed about $18 million in Hong Kong of its $1 billion invested internationally so far. He said he expects the Hong Kong investments to be a topic at the June board meeting.

"Some board members will be surprised that we have anything in Hong Kong," he said.

Executives of the $2.8 billion Los Angeles Fire & Police Pension System had decided in December to invest up to 5% of its portfolio overseas, but had not placed any of it yet.

"As it turns out, by a lucky chance, that is OK," said Allan Moore, the system's assistant manager.

Like many first-time international investors, Mr. Moore's fund mostly will leave country allocation decisions to its money managers, except in cases where trustees voice concerns.

Many money managers are urging calm in a situation they say is not unusual for the

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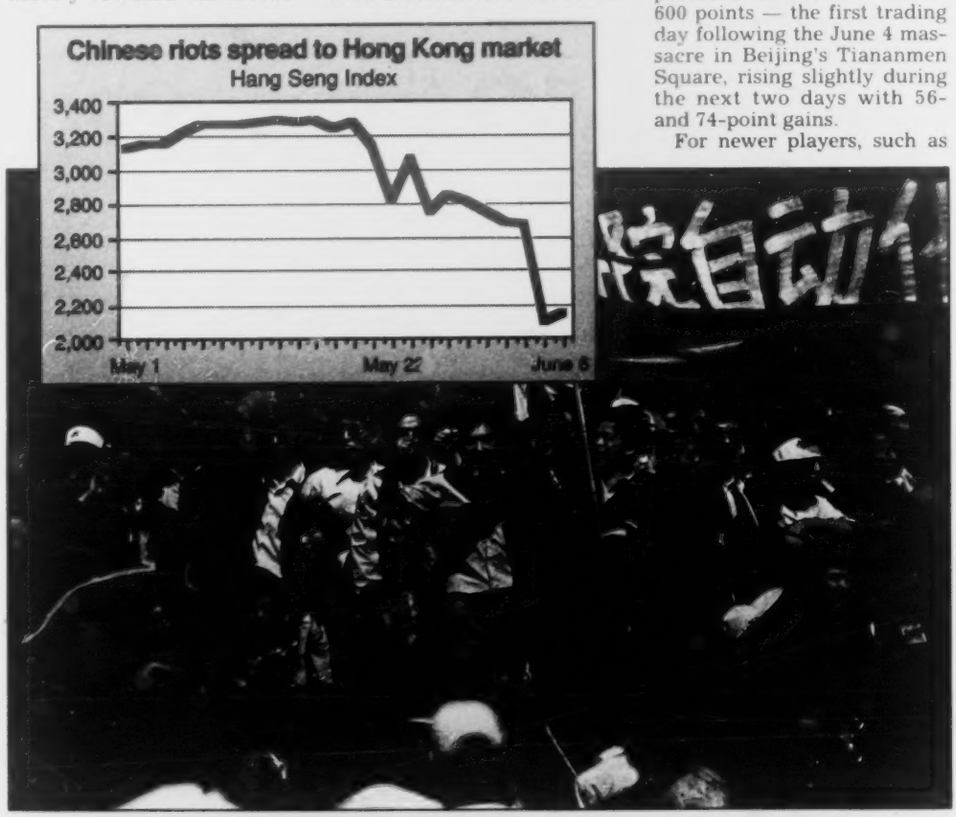

Soft dollars enter bond arena

By Joel Chernoff

Soft dollars, long a much-debated staple of common stock transactions, are becoming a part of fixed-income trades as well.

More than one-quarter of fixed-income money managers cranked soft-dollar credits out of bond trading last year, according to a forthcoming survey by Greenwich Associates, Greenwich, Conn.

While vagaries in the data make it difficult to nail down just how much soft-dollar activity was generated in bonds, Greenwich does say some $235 million in soft-dollar allocations were made by money managers from corporate bond trades alone — a staggering sum given that Greenwich says only $400 million in soft-dollar allocations were made on the equity side.

Because most bond managers apparently use soft dollars to a very limited extent, only a few major users account for much of the activity.

Most of the soft-dollar activity in the fixed-income area stems from commissions from buying new bond issues — a longstanding practice — but a sizable proportion comes from an infant secondary bond trading market offered by soft-dollar brokers, such as Citicorp's Lynch, Jones and Ryan and Donaldson, Lufkin & Jenrette's Autranet unit, both in New York.

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LATE NEWS

Investors weigh new Time offer

Institutional investors had mixed reactions to Paramount Communications Inc.'s hostile bid for Time Inc.

John Cabell, assistant vice president and senior research analyst with NCNB Texas National Bank, Dallas, said Paramount's cash offer of $175 a share has more value for Time shareholders than Time's proposed merger with Warner Communications Inc. Under the merger, Warner shareholders would receive 0.465 shares of Time for each Warner share they hold, and Warner holders would end up controlling 60% of the merged company. NCNB Texas, a shareholder in all three companies, likely will tender its Time shares to Paramount if there are no other offers, Mr. Cabell said.

Eugene Sit, president of Sit Investment Associates Inc., Minneapolis, said choosing between the two deals is "a tough call." Both Time and Warner are valuable companies, and Paramount's bid for Time is a smart move, he said. Mr. Sit's firm also holds all three companies.

But Anthony Watson, chief international investment officer of Citicorp Investment Management, said "one just wonders whether (Paramount's bid) can pay off." Citicorp also owns stock in all three. Mr. Watson said he thinks the proposed merger would be more likely to preserve shareholder value.

Call for tougher auditing lauded

WASHINGTON — Pension experts applauded the Department of Labor's Inspector General for demanding tougher auditing standards be applied to pension and welfare plans.

But Inspector General J. Brian Hyland's comparison of the private pension industry and savings and loans was "not logical," said Andrew Capelli, partner at Peat, Marwick, Main & Co., New York.

In his semiannual report, Mr. Hyland warned inadequate auditing of plans leaves many violations of the Employee Retirement Income Security Act of 1974 hidden, and that transgressions rarely are reported and auditors' reports are too old to be useful.

ESOP bill stymies Brunswick

WASHINGTON — A bill to repeal the 50% interest exclusion for debt issued to finance employee stock ownership plans is putting an immediate hold on ESOP financings, including the $100 million Brunswick Corp. public debt offering, until corporate executives evaluate its implications.

"We are virtually at a standstill," said Ross H. Stemer, Brunswick's director-corporate communications, in terms of financing. The ESOP itself won't be affected, although its financing may be more costly should the bill become law, he added. *(Another story on Brunswick's ESOP appears on page 6.)*

House Ways and Means Committee Chairman Dan Rostenkowski, D-Ill., introduced the bill, complaining corporations are rushing to finance ESOP to obtain tax benefits rather than to provide employee benefits.

Termination ruling overturned

WASHINGTON — A U.S. Supreme Court decision last week is being hailed as a victory for some that have terminated defined benefit pension plans, but experts say the ruling will lead to new litigation.

In an 8-1 decision, the high court overturned a much-criticized 4th U.S. Circuit Court of Appeals decision that participants in a terminated overfunded defined benefit plan are entitled to special subsidized early retirement benefits even if the participants had not met age and service requirements.

In their decision in Mead Corp. vs. B.E. Tilley et al., justices rejected the appellate ruling that Section 4044(a) of the Employee Retirement Income Security Act gives participants rights to additional unearned benefits following a termination. The case was returned to the lower court to determine if participants are entitled to benefits under other ERISA provisions.

California to boost international

SACRAMENTO, Calif. — Trustees of the $46 billion California Public Employees' Retirement System have agreed on an asset allocation revision that boosts international investments at the expense of domestic ones.

The approved targets call for international investments to make up 16% of the portfolio, split evenly between fixed-income and equity investments, up from 10% approved last year. The target for domestic fixed income was lowered to 35% from 40%, and that for domestic equities dropped to 35% from 36%, according to Basil Schwan, assistant executive officer.

The trustees will meet this week to approve funding schedules for the allocations, which they approved in April.

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Arbitrage made easy

But NYSE stock basket could cut profits

By Trudy Ring

The New York Stock Exchange's proposed stock basket product could simplify — and possibly remove much of the profit from — index arbitrage, as well as ease market volatility, institutional investors say.

The "exchange stock portfolio" would mirror the Standard & Poor's 500 Stock Index. In effect, investors would buy or sell a basket of stocks, in one transaction, that represent the S&P 500. Buyers and sellers of the basket would trade the actual stocks, which is not the case with futures, options and index participation contracts, all of which are settled in cash.

With a minimum trade of $5 million, the product is aimed at institutions. The NYSE expects trading to begin in September, subject to approval by the Securities and Exchange Commission.

The index basket could have an impact on index arbitraging, also known as program trading. Index arbitrageurs use computers to detect when S&P 500 futures prices are out of line with the prices of the actual stocks in the index. The arbitrageurs then buy whichever is cheaper and sell that which is more expensive.

This, however, involves buying or selling the actual stocks in the index individually in the correct weighting, which can be time consuming and costly. Being able to trade a basket of stocks in one transaction will simplify, accelerate and reduce the cost of the arbitrage.

"It could conceivably make it easier to arbitrage stocks and futures," said Charley Weaver, director of the $6.5 billion pension fund at Southwestern Bell Corp., St. Louis. "In fact, it might make it so easy that the spreads (between stock and futures prices) would narrow."

This would take much of the profit out of index arbitrage, but could lead to less market volatility, Mr. Weaver said. He noted such program trading activity might have contributed to recent market swings. The Southwestern Bell fund doesn't do index arbitrage, he said.

Jeffrey Geller, vice president of BEA Associates Inc., New York, agreed the basket likely will provide a more efficient way of doing arbitrage and will narrow stock-futures spreads. By reducing futures mispricings, this would make futures a more attractive hedging vehicle, he said. BEA manages index funds, arbitrage and hedging strategies for clients.

Also, while the proposed product is a plain-vanilla S&P 500 portfolio, it could pave the way for trading of customized portfolios, Mr. Geller said.

The proposed basket will give arbitrageurs an alternative to the NYSE's direct-order transfer system, through which they can instantaneously make trades with specialists in each of the stocks in the index, said R. Steven Wunsch, vice president in the financial futures department at Kidder, Peabody & Co. Inc., New York. "That is at least a realistic expectation," he said.

He cautioned against expecting the basket to produce radical changes in the market. "I'm in a

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LBO firms 'store' execs

By Marlene Givant Star

The crusty cliche of free enterprise — good help is hard to find — is pushing leveraged buy-out firms and their headhunters in unorthodox directions to recruit talented corporate managers.

Several firms have started "warehousing" top operating executives, paying them $200,000 to $250,000 a year to work with the firms to find an attractive company. "Then (the executive) steps in to run it," said Steven B. Potter, managing director of Russell Reynolds Associates Inc., New York, an executive recruiting firm.

This increasingly popular process usually takes seven to eight months, with most firms warehousing only one or two executives at a time because of the expense involved.

With the buy-out arena more crowded than ever and European firms seeking out U.S. professionals for cross-border restructurings, seasoned executives to run the companies taken private and to find new targets are in greater demand than ever.

"In a buy-out, money is cheap; it's everywhere. What is valued are good deals. Part and parcel of that are good managers. It makes the difference between a 40% to 60% return and bankruptcy," said Mr. Potter.

"You can sit and wait for resumes to come to you or go out and find (the executives). They're such rare birds that if you sit back and wait, you're not maximizing your chances for success," said Mary Bechmann. Ms. Bechmann is vice president and partner in Weiss, Peck & Greer Investments, New York. The firm runs the $100 million Corporate Development Associates leveraged buy-out fund, which invests in distressed companies.

Weiss, Peck & Greer concocted its own recipe for warehousing when it teamed up with Charles Gallagher, formerly president and chief executive officer of Susquehanna Corp., Englewood, Colo. He and another Susquehanna executive were seeking their own company to turn around but needed a strong financial backer.

"We spent literally 18 months schlepping around the country with them looking for a deal," said Ms. Bechmann, before the group bought a small, distressed industrial mineral and chemical division of International Minerals & Chemical Corp., Northbrook, Ill., two years ago.

The new Deerfield, Ill.-based private company, AIMCOR, generates about $400 million in revenue and has since repaid $90 million in bank debt and formed an employee stock ownership plan.

Weiss Peck & Greer is close to contracting with one or two senior executives for similar arrangements, Ms. Bechmann said.

The latest approach to the people crunch is to offer headhunters a piece of a deal's profits in exchange for finding chief executive officers with turnaround ability or companies that need a makeover.

Weiss, Peck & Greer also brought in management consul-

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Partnership finds good deals scarce

By Steve Hemmerick

FARMINGTON, Conn. — Some big pension funds are finding a good leveraged buy-out deal is hard to find.

Executives of the limited partnership of Harry Gray, Mel Klein & Partners, Farmington, Conn., reported to their pension fund limited partners that they have looked at 235 potential deals during the past 18 months. They didn't find one in which they wanted to invest or on which they haven't been outbid.

Investors in the partnership include the $37.6 billion pension fund of General Motors Corp., New York; the $8.5 billion pension fund of Boeing Co., Seattle; the $9 billion Los Angeles County Retirement Association, Los Angeles; and the $38 billion New York State & Local Retirement Systems, Albany.

Executives of the General Motors and New York State funds said they are not particularly alarmed about the situation.

"It's still not too late" to make a deal, a GM spokesman said. While GM pension officials certainly would like to see the partnership make some good deals, they also don't mind seeing it avoid bad deals, the spokesman said.

Officials of the New York State system met with the partnership's management recently, said Claudia Hutton, assistant press secretary to Comptroller Edward V. Regan. "We expressed concern that they not rush into a deal, just to make a deal," she said. The partnership's goal is to make a good deal, not just a first deal, and the retirement fund shares that, she said.

Pension funds committed $495 million of the $545 million in equity capital ready to invest, and the general partners committed the rest. The partnership has drawn down $55 million from the pension funds — including $15 million from Los Angeles County — which is invested in short-term instruments.

The partnership has a high-powered investment advisory board, including Harold W. Haynes, executive vice president, chief financial officer and director of Boeing; James Kelliher, director for private placements at GM; and Walter T. Dec, director of private market investments at GM.

The general partners include Harry J. Gray, former chief executive officer and chairman of the board of United Technologies Corp., and Melvyn N. Klein, a merchant banker and former senior vice president with Donaldson, Lufkin and Jenrette Inc.

One of the partnership's recent bids was for the Ohio Mattress Co., Cleveland. But the partners

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IRS rules on ESOP issues

By Barry B. Burr

The Internal Revenue Service, in two separate rulings, enhanced the financing choices and tax advantages of employee stock ownership plans.

Under one ruling, the IRS will allow investment banks to underwrite and make markets in publicly traded debt of leveraged ESOPS without jeopardizing the tax benefits. The immediate beneficiaries of the ruling are McDonald's Corp. and Brunswick Corp., each of whose ESOP is offering $100 million of notes, the first two companies to issue publicly traded debt to finance leveraged ESOPs.

In the other decision, the IRS issued a private-letter ruling allowing dividends paid on stock held by a payroll-based employee stock ownership plan to be used to pay off a leveraged ESOP loan. The tax advantages of PAYSOPs were eliminated in tax reform legislation enacted in 1986, effectively killing PAYSOPs.

But Eric A. Raps, accountant with Arthur Andersen & Co., Washington, said the private letter ruling means dividend deductions afforded to corporations for stock held by ESOPs aren't limited to dividends on stock that was acquired with funds generated by an ESOP loan.

"The ability of an employer maintaining a leveraged ESOP to use dividends on shares that were not leveraged to pay off an ESOP loan raises some interesting planning opportunities," he said. "For example, an employer could transfer employer stock from a profit-sharing plan or stock bonus plan to a leveraged ESOP and generally would be able to claim a deduction if the dividends on the transferred stock are used to pay off the ESOP loan."

In the other ruling on publicly traded ESOPs, the IRS allows any other non-qualified investor, including investment banks, to invest in ESOP debt without harming the tax benefits for qualified investors. But only qualified investors may use the tax benefits afforded ESOP debt.

The ruling provides the biggest boon to investment bankers; other non-qualified investors are expected to have little interest.

Before the ruling, investment bankers for the first two publicly traded ESOP offings, those of McDonald's and Brunswick, were proceeding to act as agents, not underwriters.

The two companies, however, took opposite positions on investment by non-qualified holders in secondary trading of their ESOP debt and the use of investment bankers as market makers (*Pensions & Investment Age*, May 29).

McDonald's planned before the ruling to have its investment banker, Salomon Brothers Inc., make markets in any secondary trading in the debt, believing the tax advantages would remain intact to subsequent qualified debtholders. Brunswick was taking a more cautious approach. It planned to have its investment bankers, Merrill Lynch Capital Markets and Shearson Lehman Hutton Inc., serve only as agents in secondary trading, fearing non-qualified purchasers of the debt would jeopardize the tax benefits for subsequent purchases by qualified holders. ■

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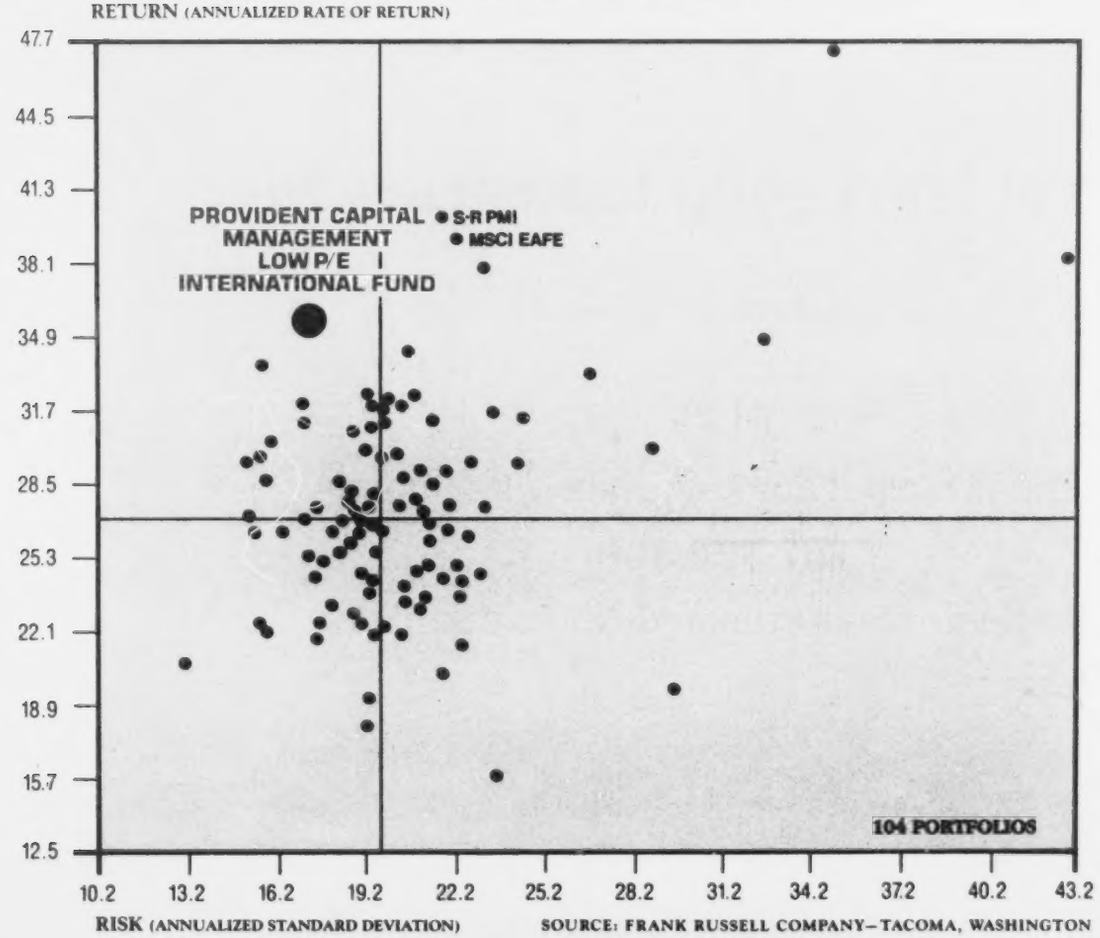

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Consultant cuts ties to Milwaukee

MILWAUKEE — Ennis, Knupp & Associates resigned as consultant to the $1.5 billion City of Milwaukee Employes' Retirement System after losing project work to a rival consultant and failing to obtain full retainer status.

SEI Corp.'s Chicago office was awarded an asset planning project and placed on full retainer status. In addition, the fund switched its transaction cost analysis to SEI from Abel/Noser Corp., New York.

James Knupp, principal of Chicago-based Ennis, Knupp, who first disclosed his firm resigned the account, explained his firm wasn't interested in providing only performance reviews as it had been doing in the two years it was under contract with the board.

He said the firm otherwise could have continued under its current arrangement, which Robert G. Nehls, the fund's secretary and executive director, confirmed.

Mr. Nehls said he and the board were surprised by Ennis, Knupp's abrupt resignation. He suggested Ennis, Knupp might have been disappointed because it lost in the competition to do the asset planning study and because the fund denied Ennis, Knupp's request for a fee increase to move it onto full retainer status, while at the same time placing SEI on full retainer.

The fund expects SEI to complete the asset planning study by the end of July.

Mr. Nehls said the fund's board did not ask Ennis, Knupp to reconsider its resignation. He said the board hasn't indicated if it will contract with another consulting firm to replace Ennis, Knupp.

"To us, consulting goes beyond reporting performance," Mr. Knupp said, explaining the resignation.

He said Ennis, Knupp resigned to devote its resources to "more meaningful work" among its 31 remaining clients. "We're extremely busy," he added.

Mr. Nehls said the fund replaced Abel/Noser because of the quality of SEI's work and the desire of the board to have one fewer consultant presenting reports. ■

CORRECTIONS & CLARIFICATIONS

• In a May 29 story on Pensions & Investments' Performance Evaluation Report for international commingled funds, the one-year return for the **Morgan Stanley Capital International Europe Australia Far East Index** was incorrect. The EAFE returned 11.9% for the year ended March 31, vs. 11.23% for the FT-Actuaries Europe-Pacific Index.

• **Arthur Andersen & Co.**'s name was misspelled in a story in the May 29 issue.

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